



DEPARTMENT OF THE TREASURY

Internal Revenue Service
TE/GE EO Examinations
1100 Commerce Street
Dallas, TX 75424

501.03-00

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

June 10, 2010

Release Number: 201037033

Release Date: 9/17/10

LEGEND

ORG = Organization name XX = Date Address = address

ORG
ADDRESS

Person to Contact:
Identification Number:
Contact Telephone Number:
In Reply Refer to: TE/GE Review Staff
EIN:

CERTIFIED MAIL – RETURN RECEIPT REQUESTED

Dear

This is a Final Adverse Determination Letter as to your exempt status under section 501(c)(3) of the Internal Revenue Code. Your exemption from Federal income tax under section 501(c)(3) of the code is hereby revoked effective September 1, 20XX. You agreed to this proposed action per signed Form 6018 on April 28, 20XX.

Our adverse determination was made for the following reasons:

You have failed to establish that you operated exclusively for exempt purposes within the meaning of section 501(c)(3) of the Internal Revenue Code. Despite furthering exempt purposes to some extent, your net earnings inured to the benefit of private shareholders or individuals of your organization. In addition, more than insubstantially, you operated for the private interests of designated individuals in contravention of the exemption requirements contained in Treas. Reg. section 1.501(c)(3)-1(d)(1)(ii).

Contributions to your organization are no longer deductible under section 170 of the Internal Revenue Code. You are required to file Federal income tax returns on Form 1120. These returns should be filed with the appropriate Service Center for the year ending August 31, 20XX, and for all years thereafter.

Processing of income tax returns and assessment of any taxes due will not be delayed should a petition for declaratory judgment be filed under section 7428 of the Internal Revenue Code.

1100 Commerce Street Dallas, TX 75424

If you decide to contest this determination in court, you must initiate a suit for declaratory judgment in the United States Tax Court, the United States Claim Court or the District Court of the United States for the District of Columbia before the 91st day after the date this determination was mailed to you. Contact the clerk of the appropriate court for the rules for initiating suits for declaratory judgment.

You also have the right to contact the office of the Taxpayer Advocate. However, you should first contact the person whose name and telephone number are shown above since this person can access your tax information and can help you get answers. You can call 1-877-777-4778 and ask for Taxpayer Advocate assistance. Or you can contact the Taxpayer Advocate from the site where the tax deficiency was determined by calling: Or you can contact the Taxpayer Advocate nearest you by calling: or writing to: Internal Revenue Service, Office of Taxpayer Advocate:

Taxpayer Advocate assistance cannot be used as a substitute for established IRS procedures, formal appeals processes, etc. The Taxpayer Advocate is not able to reverse legal or technically correct tax determinations, nor extend the time fixed by law that you have to file a petition in the United States Tax Court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling.

We will notify the appropriate State Officials of this action, as required by section 6104(c) of the Internal Revenue Code.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely yours,

Nanette M. Downing
Director, EO Examinations



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY

Internal Revenue Service
9350 Flair Dr., 2nd Floor
El Monte, CA 91732-2828

May 11, 2009

ORG
ADDRESS

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

Certified Mail - Return Receipt Requested

Dear

We have enclosed a copy of our report of examination explaining why we believe revocation of your exempt status under section 501(c)(3) of the Internal Revenue Code (Code) is necessary.

If you accept our findings, take no further action. We will issue a final revocation letter.

If you do not agree with our proposed revocation, you must submit to us a written request for Appeals Office consideration within 30 days from the date of this letter to protest our decision. Your protest should include a statement of the facts, the applicable law, and arguments in support of your position.

An Appeals officer will review your case. The Appeals office is independent of the Director, EO Examinations. The Appeals Office resolves most disputes informally and promptly. The enclosed Publication 3498, *The Examination Process*, and Publication 892, *Exempt Organizations Appeal Procedures for Unagreed Issues*, explain how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process.

You may also request that we refer this matter for technical advice as explained in Publication 892. If we issue a determination letter to you based on technical advice, no further administrative appeal is available to you within the IRS regarding the issue that was the subject of the technical advice.

If we do not hear from you within 30 days from the date of this letter, we will process your case based on the recommendations shown in the report of examination. If you do not protest this proposed determination within 30 days from the date of this letter, the IRS will consider it to be a failure to exhaust your available administrative remedies. Section 7428(b)(2) of the Code provides, in part: "A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted its administrative remedies within the Internal Revenue Service." We will then issue a final revocation letter. We will also notify the appropriate state officials of the revocation in accordance with section 6104(c) of the Code.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Sunita B. Lough
Director, Exempt Organizations Exam

Enclosures:
Publications 892 & 3498
Report of Examination
Form 6018

Form 886-A (Rev. January 1994)	EXPLANATION OF ITEMS	Schedule number or exhibit	
Name of Organization/Taxpayer	Tax Identification Number	Year/Period ended	
ORG		8/31/20XX	

LEGEND

ORG = Organization name XX = Date City = city State = state Country = country Agent = agent DIR-1 = 1st
 DIRECTOR President = president RA-1 = 1st RA Program-1, Program-2 & Program-3 = 1st, 2nd, & 3rd Program CO-1, CO-2, CO-3, CO-4 & CO-5 = 1st, 2nd, 3rd, 4th & 5th COMPANIES

ISSUE

1. Whether the activities conducted by ORG ("ORG") throughout the years of its existence were in compliance with the rules and regulations under the Internal Revenue Code ("IRC" or "the Code") §501(c)(3).
2. Whether ORG complied with record keeping requirements as required under the Code §§ 6001 and 6033.

FACTS

Organizational Information:

ORG was incorporated on November 14, 19XX, in the State of State. The articles of incorporation did not contain any specific purpose of ORG. The initial agent for service of process was DIR-1.

The Internal Revenue Service ("the Service") received the Form 1023, *Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue code*, signed by President, spouse of DIR-1 and President of ORG, on November 19, 19XX. Its intended purposes as described in the application were:

"ORG is formed to assist poor and needy children and families living in the inner-cities of the United States and in developing Third World countries. This assistance will be provided by the operation and support of schools, clinics, feeding centers and community development projects in the communities in which the children and families live.

- A. Assume responsibility for a project in South Central State in which after school tutoring and recreation are offered. There will be field trips for the children to museums, sports events, and the beach.
- B. Partnership with CO-1 [sic], providing [sic] support and volunteers for pre and post natal care clinics.
- C. Partnership with CO-2 in the support and operation of an elementary school in City [sic] State.
- D. Working with Lutheran and Presbyterians in providing food for needy families and a weekly feeding program.
- E. Partnership with Catholic nuns who are operating a home and school for educable [sic] mentally handicapped children and youth. ORG will recruit sponsors who will support extra recreational activities
- F. Operating four (4) elementary [sic] schools Country; recruiting volunteers from churches to travel to Country to build classrooms, with the first teams going in Spring, 19XX.
- G. Operating a school and feeding program for the very poor in Country.
- H. Partnership with local fundamentalist church to operate a preschool in Country, the Country.

Form 886-A (Rev. January 1994)	EXPLANATION OF ITEMS		Schedule number or exhibit
Name of Organization/Taxpayer ORG		Tax Identification Number	Year/Period ended 8/31/20XX

ORG will distinguish itself by making long-term commitments to the communities it serves, thus making it possible for permanent changes in the educational, health, and economic welfare of the children and families in the target communities. The organization will seek to identify and train parents and community leaders who are capable of continuing the ORG efforts and activities into the future.

ORG will take over projects which have been abandoned by several other organizations for a variety of reasons. This will give ORG an immediate urgency to enroll sponsors to children and families that have already experienced the benefits of child sponsorship programs and are anxious to see them reinstated. Building on these projects also gives the organization a source of contributions from former sponsors who can be contacted and re-enrolled.

ORG is being formed to create opportunities for a better life for poor and needy children in the world, by providing them with the training and opportunities necessary to realize that better life.

ORG will collaborate with other organizations wherever possible to reduce overhead and staff expenses.

ORG will operate and support a variety of programs such as preschools, elementary schools, after school tutoring and recreational activities, feeding programs, clinics, parenting classes, vocational training classes, activities which improve the general welfare of the community.

Initially, most of the projects and activities the organization were organized and operating until the last 12 – 18 months. Therefore, the efforts involved will require reviving them through on-site visits. It will take three or four years to revive the projects and activities currently identified and targeted. Once those projects are revived, ORG will seek to expand into other, new communities. Whether in the United States or abroad, the communities must request the assistance and partnership of ORG. They must be willing to contribute significance personnel and community resources to the project to achieve an honest partnership that will result in effective self-help to the community, its children and families.

ORG will rely upon the experience and contacts of its President to implement it [sic] programs and activities.”

In response to the question “What are or will be the organization’s sources of financial support?” of Form 1023, ORG stated “Commodities (in-kind gifts of food, medicines, books, etc.), child sponsorships, direct mail and public appeals, grants from churches & civic clubs, business sponsorships, and special events.”

In response to the question “Describe the organization’s fundraising program” of Form 1023, ORG stated

“A. Initially, the major fund raising activity will be to enroll sponsors who contribute a specific amount each month toward the support of a sponsored child...

Form 886-A (Rev. January 1994)	EXPLANATION OF ITEMS	Schedule number or exhibit	
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ORG		8/31/20XX	

- B. Newsletters, with appeals, will be sent to everyone who hears a presentation at a church or school and request more information.
- C. Take out ads in various publications to promote ORG child sponsorship and invite readers to become sponsors.
- D. Make presentations and request support from service clubs like CO-3, CO-4, and CO-5.
- E. Long term sources of income will be the Combined Federal Campaign and United Way (in communities where we have established projects.
- F. Coin canisters placed on the counters in communities in City and adjacent counties.
- G. Use celebrity contacts that friends of ORG have to host a special event to promote child sponsorship and raise funds.
- H. Use celebrities to create public service announcements which promote ORG and invite people to become child sponsors.
- I. Obtain contributions of various commodities such as food, medicines, and books to be used in projects managed by ORG or its partner organizations.”

The proposed budget for fiscal year 19XX and 19XX included revenues titled “commodities” in the amount of \$ and \$, respectively.

A determination letter was issued on March 4, 19XX granting exemption status under the Code § 501(c)(3) as an organization described under the Code §§ 509(a)(1) and 170(b)(1)(A)(vi) with an advanced ruling period from November 14, 19XX through August 31, 20XX. In a letter dated January 15, 20XX, the Service reaffirmed the exempt status of ORG as a publicly supported organization.

Operational Information:

The Service initiated a review of the Forms 990, *Return of Organization Exempt From Income Tax*, and activities of ORG for the years ending August 31, 19XX. Agent observed that ORG had poor internal control. ORG was warned in the closing letter to improve its internal control. Agent recommended for a future examination to determine whether the internal control has been improved.

On April 23, 20XX, the Service initiated a follow-up review of the Forms 990 and activities of ORG for the years ending August 31, 20XX. Agent encountered many delays and did not receive most of the requested records.

Agent issued three Forms 4564, *Information Document Request* (“IDR”), asking for records necessary to understand the operation of ORG. It took ORG 75 days to provide the first response and the response was incomplete. As of 3/30/XX, the balance of the request on IDR #1 has been outstanding for 341 days, the

Form 886-A (Rev. January 1994)	EXPLANATION OF ITEMS	Schedule number or exhibit	
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ORG		8/31/20XX	

balance of the request on IDR #2 has been outstanding for 245 days, and the entire request on IDR #3 has been outstanding for 140 days.

DIR-1 was listed as the president of ORG on the Forms 990 filed since the year ending August 31, 19XX. ORG describes its purpose and activities on the Form 990 for the year ending 8/31/XX as follows:

“Purpose: To aid poor and needy children and families through food, clothing, health care, education, and community development; and to provide Americans with an opportunity to make a difference in the lives of poor and needy children through their support and participation in our programs and participating in developing awareness of the needs of the poor and going to Third World countries for short-term experiences.

ORG has three major programs in the United States

1. “Program-1” allows Americans of all ages a short-term opportunity to live and work among the poor in Third World countries. A group of 19 volunteers went to Country, Central America, and refurbished an abandoned area of a pre-school school that serves 24 preschoolers of working mothers. Plans are to expand this program to several countries in the near future.
2. ORG promotes the annual Program-2 in schools around the country and provides lesson plan and projects suggestions that encourage students to “think globally while acting locally.” Thousands of teachers and an unknown number of students were reached through booths and presentations at state and national teachers’ conventions that informed them of the annual Program-2 activities and invited them to visit ORG’s Web Site that contains a special resource section for teachers and students. No teachers or students received scholarships in the Program Year ending August 31, 20XX, because in the aftermath of the Terrorist Attack on America, school districts and individuals were unwilling to promote travel outside of the U.S., especially to live and work among the poor in a Third World country. The poor are considered prime targets for the recruitment of terrorists. ORG is working at focusing on the fact that these trips are not to countries where al Qaeda and other anti-American terrorists are active.
3. ORG developed and invested staff and volunteer time and energy to develop a new program that will expand the utilization of donated boats. The Program-3 uses donated boats to provide training in water safety, teach ocean ecology, and hand-on experiences in boats. These classes and opportunities are offer to inner-city children & youth, and the physically challenged; people who would not ordinarily receive such training or experiences on the water and in boats. Donated boats are used in the program and subsequently sold, they are listed at their fair market values as determined by a certified appraiser, paid by the donor. Boat crews and trainers all donate their time.

ORG has major projects in Developing Countries.

Form 886-A (Rev. January 1994)	EXPLANATION OF ITEMS	Schedule number or exhibit	
Name of Organization/Taxpayer	Tax Identification Number	Year/Period ended	
ORG		8/31/20XX	

It operates its own elementary schools in Country, Country, and the Country. It supports and partners in schools in Country and Country. Approximately 1600 students are enrolled. ORG's schools are preschool through 9th grade, except Country where the school is for educable [sic] retarded youth."

During the interview, DIR-1 reiterated the activities above in general terms. There was no "Program-1" in the fiscal year 20XX. Should there be such an activity, ORG would be one of the organizing entities, and would not provide any funding to the participating individuals. There was no "Program-2" activity in the fiscal year 20XX.

ORG talked about operating elementary schools and sponsoring kids in Third World countries. These two activities were collectively accomplished by wiring funds to organizations in Third World countries. In the fiscal year 20XX, ORG wired less than \$ to Country and the Country for this purpose. This represents less than 0.15% of the total expenses shown on the return. The general ledger indicated that ORG received about \$ in cash contributions from various sources. The funds wired to Country and the Country represented about 6% of the cash contributions.

Gifts-in-kind Activity

ORG reported \$ worth of gifts-in-kind ("GIK") goods received and distributed on its Form 990 for the year ending 8/31/XX and described this activity as follows:

"Gifts-in-kind are reflected at their estimated fair market values as of the date of receipt. This represents certain bulk commodity items shipped to program sites. Such items include used clothing, medicines, and medical supplies. ..."

"ORG distributed the following commodities:

1. Two containers of medicine and medical supplies, valued at \$, were distributed to over 30,000 victims from the December 26, 20XX Tsunami in Country in collaboration with local Christian organizations.
2. A container of used clothing, valued at \$, was distributed in Country to an estimated 15,000 persons who were victims of the December 26, 20XX Tsunami. ORG worked in collaboration with local Christian organizations.
3. One large container and one small container of Medicines and medical supplies, valued at \$, were distributed through primary health care clinics that were used by hurricane victims in Country. ORG worked through in [sic] Country Branch, Association of Life. Medical care and medicines were arranged to go into very poor areas that were devastated by mudslides that followed the heavy rain from the hurricane. An estimated 30,000 persons of all ages were given assistance."

Form 886-A (Rev. January 1994)	EXPLANATION OF ITEMS	Schedule number or exhibit	
Name of Organization/Taxpayer	Tax Identification Number	Year/Period ended	
ORG		8/31/20XX	

DIR-1 explained the GIK activity as transactions which an exempt organization could participate in three different ways. Three exempt organizations could participate in a single shipment. The first method of participation was acting as a receiving organization. The receiving organization would receive donations from entities or businesses that no longer had needs for the goods in question. The second method of participation was acting as a shipping organization. The shipping organization would arrange for the goods to be shipped to a Third World country. The third method of participation was acting as a distributing organization. The distributing organization would arrange for someone or some organization in the Third World country to receive the goods that would be shipped over. Throughout this process, the goods would remain in a warehouse until a shipping company picked them up and shipped them to a specified destination in a Third World country.

ORG participated as a shipping organization for two of the shipments and as a distributing organization for one of the shipments. We requested shipping, valuation and distribution records, but received none of them.

Forms 990 and other records indicated the following GIK transactions for each of the fiscal years ending August 31, 19XX through 20XX:

Description	19XX08	19XX08	20XX08	20XX08	20XX08	20XX08	20XX08	20XX08	20XX08
grains & seeds									
medicines & related									
clothing									
books & school supplies									
Building materials& tools									
clothing									
food									
paints									
Total GIK									
GIK as % of revenues									
GIK as % of expenses									

n1 expense information were not available for this year

Boat Donation Program

Beginning in 20XX, ORG solicited donations of boats and other assets through its bargain-sale-purchase & donation program. A pamphlet for this program describes the process as follows:

- “1. We send you an Agreement of Bargain Sale document which ... contains a firm cash offer ... Cash offer will be below fair market value, but when the tax deductions are added together, the offer becomes attractive.
2. We also send you 2 copies of a Deed of Gift to be notarized.
3. To begin the process, fax us signed copies of above documents ...
4. ... transfer of ownership to ORG.
5. ... secure an independent appraisal of your boat ...

Form 886-A (Rev. January 1994)	EXPLANATION OF ITEMS	Schedule number or exhibit	
Name of Organization/Taxpayer	Tax Identification Number	Year/Period ended	
ORG		8/31/20XX	

6. Once [the] deal is complete, you'll need the signed IRS 8283, along with the appraisal ...
7. ORG will sell your boat. Net from the sale will be used to fund our program for poor, needy children in the U.S. and abroad."

Forms 990 filed for the years 20XX through 20XX indicate that ORG had the following bargain sales items.

Description of donated items	20XX08	20XX08	20XX08
2 Automobiles			
a piece of land			
a motor cycle			
12, 12 & 2 boats respectively			
Total donated assets			
Donated assets as a % of revenues			
Donated assets as a % of expenses			

ORG hired an individual to handle all aspects of boat donation programs. The individual was to receive all related expenses reimbursed and a percentage of net revenues as commissions. Their relationship went sour and lawsuits ensued. One of the complaints made by the individual was that ORG asked him to pay commissions to DIR-1's son, RA-1, directly through the separate funds related to boat transactions. The individual claimed that he paid RA-1, although RA-1 did little work in regards to the program. The general ledger indicated that ORG earned about \$ in net proceeds from boat sells. RA-1 received about \$\$ or 39% in consulting fees.

Financial Records:

ORG describes its financial accounting on the Form 990 for the year ending 8/31/XX as follows:

"ORG prepares its financial statements according to the accrual basis of accounting, pursuant to the American Institute of Certified Public Accountant's Industry Audit Guide, Audits of Voluntary, Health and Welfare Organizations. Financial Statement presentations follow the recommendations of Financial Accounting Standards Board in its statement of Financial Accounting Standards (SFAS) No. 117, Financial Statements of Not for Profit Organizations. The Organization has adopted the provisions of (SFAS) No. 116, "Accounting for Contributions Received and Contributions Made, that requires ORG to recognize pledges as revenue when received and to record them as unrestricted temporarily restricted, or permanently restricted support, depending on the existence and/or nature of any donor restrictions. There were not temporarily or permanently restricted assets as of August 31, 20XX and 20XX."

However, we were unable to reconcile the general ledger to the return filed. There were no recordings for any of the transactions related to GIK transactions. Although twelve boats were reported as sold during the fiscal year 20XX, there was no clear accounting of any of the boat transactions within the general ledger. It appeared that only the net proceeds were recorded for most of the boat transactions.

The office of ORG was located in the residential home of DIR-1. DIR-1's household had 4 to 5 family members. The rental rate was around \$/mo. The general ledger indicated ORG paid a total of \$ in rent for the fiscal year 20XX. Seventy percent (70%) of this amount was charged to ORG expenses and the remaining 30%

Form 886-A (Rev. January 1994)	EXPLANATION OF ITEMS	Schedule number or exhibit	
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ORG		8/31/20XX	

was used to decrease the loan borrowed from DIR-1. ORG paid \$ for water usage and 72% of this amount was charged to ORG expenses and the remaining 28% was used to decrease the loan borrowed from DIR-1. ORG paid \$ for other utility expenses and 51% of this amount was charged to ORG expenses and the remaining 49% was used to decrease the loan borrowed from DIR-1. We requested, but did not receive, information to determine whether allocations of these expenses were equitable.

ORG earned about \$ in contributions and bargain-sell activity and paid \$ in wages to its employees. This amount included \$ wages paid to DIR-1 on 12/30/XX.

Program-3

This activity was described on Form 990 as follows:

“Program-3 uses donated boats to provide training in water safety, teach ocean ecology, and hand-on experiences in boats. These classes and opportunities are offer to inner-city children & youth, and the physically challenged; people who would not ordinarily receive such training or experiences on the water and in the boats. 364 children and youth participated during this program year. Donated boats are used in the program and subsequently sold; they are listed at their fair market value as determined by a certified appraiser, paid by the donor.”

DIR-1 indicated this activity was handled by a friend and was unable to provide details of the operation or a tour of the boat used for this purpose.

LAW

The Code § 501(c)(3) provides for the exemption from federal income tax of corporations organized and operated exclusively for charitable or educational purposes, provided no part of the net earnings inures to the benefit of any private shareholder or individual.

The Code § 501(c)(3) states that to meet the operational test the organization exempt under the Code §501(c)(3) should have “no part of the net earnings of which inures to the benefit of any private shareholder or individual...”

The Regulation §1.501(a)-1(c) defines the words “private shareholder or individual” in §501 as “persons having a personal and private interest in the activities of the organization.”

The Income Tax Regulations (“the Regulations”) §1.501(c)(3)-1(c)(1) provides that an organization operates exclusively for exempt purposes only if it engages primarily in activities that accomplish exempt purposes specified in § 501(c)(3) of the Code. An organization must not engage in substantial activities that fail to further an exempt purpose.

The Regulation §1.501(c)(3)-1(c)(2) states “*Distribution of earnings.* —An organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.”

Form 886-A (Rev. January 1994)	EXPLANATION OF ITEMS	Schedule number or exhibit	
Name of Organization/Taxpayer	Tax Identification Number	Year/Period ended	
ORG		8/31/20XX	

The Regulation §1.501(c)(3)-1(d)(1)(ii) states, “An organization is not organized or operated exclusively for one or more of the purposes specified in subdivision (i) of this subparagraph unless it serves a public rather than a private interest. Thus, to meet the requirement of this subdivision, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.”

The Regulations §1.501(c)(3)-1(d)(2) provides that the term “charitable” includes relief of the poor and distressed or underprivileged, lessening of the burdens of government, and promotion of social welfare by conducting programs to combat community deterioration and juvenile delinquency.

The Regulations §1.501(c)(3)-1(e) provides that an organization that operates a trade or business as a substantial part of its activities may meet the requirements of §501(c)(3) of the Code if the trade or business furthers an exempt purpose, and provided the organization’s primary purpose does not consist of carrying on an unrelated trade or business.

The prohibition on inurement in the Code §501(c)(3) is absolute. The Service has the authority to revoke an organization’s exempt status for inurement regardless of the amount of inurement. See *Spokane Motorcycle Club v. U.S.*, 222 F.Supp. 151 (E.D. Wash. 1963); *The Founding Church of Scientology*, 412 F.2d 1197, 1202; *Airlie Foundation*, 283 F. Supp. 2d 58. Moreover, for purposes of establishing that inurement occurred, it is not necessary to calculate the precise amount of inurement as long as it is shown that the value of the transfer giving rise to inurement is not within a reasonable range of what could be considered fair market value. See *Anclote Psychiatric Ctr. v. Commissioner*, T.C. Memo 19XX-273.

Record Keeping Requirement

The Code § 6001 states, “Every person liable for any tax imposed by this title, or for the collection thereof, shall keep such records, render such statements, make such returns, and comply with such rules and regulations as the Secretary may from time to time prescribe. Whenever in the judgment of the Secretary it is necessary, he may require any person, by notice served upon such person or by regulations, to make such returns, render such statements, or keep such records, as the Secretary deems sufficient to show whether or not such person is liable for tax under this title.”

The Code §6033(a)(1) states, “In general. ... every organization exempt from taxation under section 501(a) shall file an annual return, stating specifically the items of gross income, receipts, and disbursements, and such other information for the purpose of carrying out the internal revenue laws as the Secretary may by forms or regulations prescribe, and shall keep such records, render under oath such statements, make such other returns, and comply with such rules and regulations as the Secretary may from time to time prescribe...”

The Regulations §1.6001-1(a) states, “*In general.* ... any person required to file a return of information with respect to income, shall keep such permanent books of account or records, including inventories, as are sufficient to establish the amount of gross income, deductions, credits, or other matters required to be shown by such person in any return of such tax or information.”

Form 886-A (Rev. January 1994)	EXPLANATION OF ITEMS	Schedule number or exhibit	
Name of Organization/Taxpayer ORG	Tax Identification Number	Year/Period ended 8/31/20XX	

The Regulations §1.6001-1(c) states, “*Exempt organizations.* —In addition to such permanent books and records as are required by paragraph (a) of this section with respect to the tax imposed by section 511 on unrelated business income of certain exempt organizations, every organization exempt from tax under section 501(a) shall keep such permanent books of account or records, including inventories, as are sufficient to show specifically the items of gross income, receipts and disbursements. Such organizations shall also keep such books and records as are required to substantiate the information required by section 6033.”

The Regulations §1.6001-1(e) states, “*Retention of records.* —The books or records required by this section shall be kept at all times available for inspection by authorized internal revenue officers or employees, and shall be retained so long as the contents thereof may become material in the administration of any internal revenue law.”

The Revenue Ruling 59-95, 1959-1 CB 627, (Jan. 01, 1959) states, “An organization previously held exempt from Federal income tax was requested to produce a financial statement as of the end of the year and a statement of its operations during such year. However, its records were so incomplete that it was unable to furnish such statements. ... *Held*, failure or inability to file the required information return or otherwise to comply with the provision of section 6033 of the Code and the regulations which implement it, may result in the termination of the exempt status of an organization previously held exempt, on the grounds that the organization has not established that it is observing the conditions required for the continuation of an exempt status.”

Effective date of revocation

An organization may ordinarily rely on a favorable determination letter received from the IRS. The Regulations §1.501(a)-1(a)(2); Revenue Procedure 20XX-4, §14.01 (cross-referencing §13.01 et seq.), 20XX-1 C.B. 123. An organization may not rely on a favorable determination letter, however, if the organization omitted or misstated a material fact in its application or in supporting documents. In addition, an organization may not rely on a favorable determination if there is a material change, inconsistent with exemption, in the organization’s character, purposes, or methods of operation after the determination letter is issued. The Regulations § 601.201(n)(3)(ii); Revenue Procedure 90-27, §13.02, 1990-1 C.B. 514.

The Commissioner may revoke a favorable determination letter for good cause. The Regulations § 1.501(a)-1(a)(2). Revocation of a determination letter may be retroactive if the organization omitted or misstated a material fact or operated in a manner materially different from that originally represented. The Regulations § 601.201(n)(6)(i), § 14.01; Revenue Procedure 20XX-4, § 14.01 (cross-referencing § 13.01 et seq.).

GOVERNMENT POSITION

Issue 1 – Operational Test

In order for an organization to retain its exempt status it must demonstrate to the Service that it meets both the organizational and the operational tests. ORG described what it had done on its Forms 990. However, the records did not support the existence of most of the activities. The allocation of rent and utility expenses appeared to be unreasonable and inuring to the benefit of DIR-1 and his family, private shareholders or

Form 886-A (Rev. January 1994)	EXPLANATION OF ITEMS	Schedule number or exhibit	
Name of Organization/Taxpayer	Tax Identification Number	Year/Period ended	
ORG		8/31/20XX	

individuals. Therefore, the activities as described above did not meet the operational test as described under §1.501(c)(3)-1(c) of the Regulations.

Issue 2 – Record Keeping Requirement

Through out the examination, ORG was unwilling or unable to produce the records necessary to support and substantiate the financial information reported on the annual return it filed. The records it reconstructed to explain the transactions did not match other records that were contemporaneously prepared. Accordingly, ORG failed to comply with requirements under the Code §§ 6001 and 6033 and the Regulations thereunder.

CONCLUSION

An organization can not be recognized as exempt under §501(c)(3) of the Code unless it shows that it is operated exclusively for charitable, education, or other exempt purposes. Among other things, ORG's activities must demonstrate conclusively that it meets the operational test of §1.501(c)(3)-1(c) of the Regulations. Based on the information secured during the examination, we conclude that ORG did not meet the operational test. ORG also failed to comply with the record keeping requirements specified under the Code §§ 6001 and 6033 and the Regulations thereunder. Therefore, the exempt status granted to ORG should be revoked effective from September 1, 20XX.

If the revocation is sustained, ORG is required to file Forms 1120 for the years ending August 31, 20XX and after.